

Business Transaction Marketplace

Information about Business Valuations, Acquisitions, & Sales

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Principled Negotiation in Business Transactions

In the [January Issue](#) of *Business Transaction MarketplaceSM*, we indicated that one of the reasons businesses don't sell is the buyer and seller could not agree on price. For businesses that do sell, the *M&A Insider* estimated that "75% of all mergers and acquisitions fail to achieve their financial and strategic objectives". One of the obvious reasons for the failure is the price paid was too high. Isn't there a way to bridge the pricing gap?



In the well-known book on negotiation titled *Getting to Yes*, the authors describe the four propositions of "principled negotiation":

- 1) Separate the people from the problem
- 2) Focus on interests not positions
- 3) Invent options for mutual gains
- 4) Insist on using objective criteria

Many deals fail because of a lack of originality in structuring a transaction. The first article below describes some inventive options from which business transactions can be structured.

As the saying goes "Cash is King". When pricing a business for transaction purposes, the current operating cash flows of the business are probably the easiest to quantify. The operating cash flows become the objective criteria, and what is discussed in the second article below.

Darrell V. Arne
CPA, ASA, CBI

Inventive Deal Structuring Options



If during negotiations, people can be separated from the problem, and buyer and seller interests identified, what's next is structuring the transaction. Buyers and sellers fail to realize that there are many options at their disposal in creating a win/win transaction. Some of the deal structuring options are listed below, organized under the following three categories: a) consideration options; b) buyer's financing options; and c) tax structuring options.

Consideration Options: cash, seller carryback notes, liability assumptions, seller debt conversion agreements, buyer's stock, earn outs, non-compete agreements, employment/consulting agreements, commission agreements, closing bonuses, severance agreements, health benefits, life insurance benefits, lease agreements, royalty agreements,

Buyer's Financing Options: cash equity, senior term debt, senior line of credit, SBA guaranteed debt, balloon notes, seller subordinated debt, second lien loans, vendor financing, consigned inventory, equipment leasing, ESOP financing, mezzanine financing, warrants, qualified plan rollover, private placements, angel investors, private equity groups, hedge funds, seller retained equity interests, contingent payment agreements, holdback and indemnification agreements

Tax Structuring Options: stock sale, asset sale, straight merger, forward triangular merger, reverse triangular merger, QSub, single member LLCs, spin-offs, split-ups, installment sale, [personal goodwill allocations](#), §338(h)(10) election, §1031 like-kind exchanges, basis of accounting elections, §351 exchanges, §721 exchanges, §83(b) election, §1042 ESOP rollover, charitable remainder trusts, GRATs, private annuities, SCINs

Maximum Price for the Seller – Satisfy Buyer’s Claimholders to Cash

Generally (but not always), sellers want the highest price. In addition, they desire the best terms to minimize risk, and a deal structure that maximizes after-tax proceeds. Buyers want to make sure they don’t overpay. The objective criteria to test for possible overpayment are the business’ operating cash flows. Earnings before interest, taxes, depreciation and amortization (EBITDA) is often the cash flow measurement from which pricing decisions are made.



If a buyer and a seller can agree that the business produces a certain level of EBITDA, then the price can be tested to see if the buyer’s post-transaction claimholders to EBITDA will be satisfied. Those four post-transaction claimholders to EBITDA are as follows:

1. Uncle Sam: The state and federal income taxes on entity profits
2. Lenders: The principal and interest repayment on acquisition loans
3. Investors: The return on and of the cash equity the buyer puts in to make the acquisition
4. Company: The working capital and capital expenditures needed for future growth

If the buyer’s claimholders to cash requirements are not met, then the price may be too high and/or terms too stringent. The reverse is true as well. If after meeting the buyer’s claimholders’ to cash, there are excess post-transaction cash flows, then the price may be too low, and/or the terms are too lenient. Therefore, not giving what the seller wants – the highest price.

There’s also a circular problem here. The buyer’s actual cash flow depends upon knowing the buyer’s post-transaction deal structure; the buyer’s post-transaction deal structure depends upon knowing the price; the price depends upon knowing the buyer’s actual cash flow. And again, the seller wants the highest price. This is where computer programming comes in to solve this circular problem.

Ultimately, the objective is to demonstrate that the pricing and deal structure satisfies the buyer’s post-transaction claimholders to cash, while satisfying the seller’s expectation of receiving the highest price and best terms. Once again . . . Cash is King!

Marketplace Alert



Albuquerque and New Mexico Rankings:

- #1: The Nation’s Best City for Business and Careers
- Forbes, May 2006
- #2: Arts Destination
- AmercianStyle Magazine, April 2006
- #3: Smartest City to Live
- Kiplinger’s Personal Finance, May 2006
- #4: New Mexico is Nation’s 4th Best State for Small Tech Industry
- Small Times Magazine, October 2006
- #5: Albuquerque is One of the World’s Five Best Vacation Destinations
- Orbitz, July 2006
- #6: New Mexico has the 6th Highest Concentration of High Tech Workers in the Nation
- American Electronics Association, April 2006

Upcoming Darrell Arne Seminars and Workshops

IBBA Conference for Professional Development
Memphis, TN; June 3-9, 2007

June 3, 2007: Succession Planning: Exit Strategies for the Privately Held Business Owner (8 hr. Course)

June 4, 2007: Tax Boot Camp for the Merger & Acquisition Professional (8 hr. Course)

June 5, 2007: Maximizing the Value of the Privately Held Company (8 hr. Course)

June 6, 2007: Working Capital and Other Balance Sheet Concepts in Negotiating and Closing Transactions (M&A Source Panelist)

June 8, 2007: The Three-Legged Stool of Business Transaction Deal Structuring (Workshop)

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